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Tangible Personal Property Tax Reform: Options to Foster Simplicity and Competitiveness in Florida's Tax Code

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Florida House of Representatives

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Mr. Chairman and Members of the Finance and Tax Committee of the Florida House of Representatives:

I write with regards to HJR 1003, the proposed constitutional amendment, and HB 1005, the implementing bill (to provide tax relief for businesses paying the tangible personal property tax). I appreciate the opportunity to submit this testimony in providing some of the broader perspective on tangible personal property taxation.

For those unfamiliar with the Tax Foundation, we are a non-partisan, non-profit organization that has monitored fiscal policy at all levels of government since 1937. We have produced the *Facts & Figures* handbook since 1941, calculate *Tax Freedom Day* each year, and have a wealth of facts, rankings, and other information at our website, www.TaxFoundation.org.

Personal property taxes are waning in popularity as a tax collection mechanism. In the past 12 years, eight states have made changes to remove or decrease the impact of tangible personal property (TPP) taxation, whether through raising the exemption or removing particularly distortionary TPP taxes on inventory. Notably, in 2008, Washington, D.C. raised its exemption to $225,000; and in 2009, Ohio began a phase-out of TPP taxation. Fourteen states already substantially exempt tangible personal property from taxes. However, these states are primarily clustered in the Northeast and Midwest. **If Florida were to remove its tangible personal property tax, it would gain notice as the only state within 600 miles to not have one**.

The economic impact of TPP taxes reaches far beyond those businesses that are required to file each year. TPP taxes are especially distortionary in their effect on people's and business's choices, which affects each member of the Florida economy.

The renewed discussion of the efficacy of tangible personal property taxes presents a golden opportunity for Florida to move toward a more simple tax code; one that encourages technological advancement and offers a more competitive business environment than neighboring states.

Compliance and Economic Impacts of Taxing Personal Property

In the movie *My Summer Story* (MGM 1994), set in 1940s Indiana, the main family learns that the TPP tax collector is en route. The whole neighborhood erupts into a flurry of activity, peddling dressers on wheelbarrows and strapping couches to the roofs of their cars, scrambling to hide anything of value from being assessed. Everyone wastes time complying with and attempting to evade the tax, and the tax certainly depresses investment in new purchases. While today's TPP usually only applies to business property, the negative effects are no different.

Tangible personal property taxes generally require that a detailed schedule of all items in a business location be inventoried, totaled, listed, and depreciated according to an approximation of fair market value over the lifetime of the product. While some standard depreciation methods exist for common products and machinery, there is a great deal of guesswork afforded to depreciation methods used for miscellaneous office supplies, specialty machinery and mundane objects.[1]

As opposed to taxes on real estate, where levies are based on official appraisals of property, the self-evaluation of personal property leaves much of the value of the product up to the discretion of the taxpayer. The present tax thus creates unfortunate incentives to evade or misrepresent tax liability.[2] They also represent a **particular barrier to start-up businesses and expanding businesses**, as their compliance burden rises with new investments.

Exemptions versus Preferential Tax Treatment

Florida currently does not tax tangible personal property until it crosses the threshold of $25,000. On one hand, this exemption prevents smaller firms from being subject to the complexities of this tax. However, institutionalizing a two-tier system where some businesses are subject to the tax and others are not may lead to distortions, as firms could structure themselves in a way to avoid the tax.

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[1] *How to Depreciate Property.* Publication 946 (2010). Internal Revenue Service website. http://www.irs.gov/businesses/small/article/0,,id=137026,00.html.

[2] Florida Tangible Personal Property Tax Return and Instructions. DR-405. http://dor.myflorida.com/dor/forms/2007/dr405a.pdf

With that said, **raising the exemption with the end goal of removing the tangible personal property tax** is an appropriate method of phasing out the tax. Giving localities the freedom to reduce rates, increase exemptions, or fully eliminate the tangible personal property tax in their jurisdiction would foster competitive approaches and should be encouraged.

Conclusion

Though tangible personal property taxes are an important revenue source to many localities, their effect on economic decision-making is not worth the price tag. Other less distortionary methods for collecting local revenue exist, and can be implemented in those jurisdictions that rely heavily on TPP revenue. The bills as proposed **provide an opportunity for Florida to improve its business tax climate** and put the state on the path to eliminating this outmoded tax.

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